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The Director of Central Intelligence
Washington, D.C. 20505

01 MAY 1985

National Intelligence Council

NIC 02177-85
25 April 1985

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

FROM: David B. Low
National Intelligence Officer for Economics

SUBJECT: Attached Talking Points on the US-USSR Joint Commercial Commission Meeting Scheduled for May 20-21 in Moscow

1. Attached are the subject talking points. They are based on six recent papers by OSOVA and OGI as well as other current intelligence. They have been reviewed by analysts from those two offices and discussed with the NIO/USSR.

2. As I discussed with you this morning, these talking points were developed in the context of an anticipated initiative by the Commerce Department to expand the kinds of oil and gas equipment which might be exported to the Soviet Union by the United States. However, under the present circumstances, including Gorbachev's recent tough comments and the Soviet statement on the Nicholson killing, Secretary Baldridge has retreated from proposing any such initiative. Thus, Commerce is relying on and will act in accordance with NSDD 155 dated January 4, 1985 in which it is stated:

> "To avoid sending inconsistent signals to the allies and the USSR, US oil and gas equipment sales should not be an area in which the US should agree to an active program of trade expansion pending further policy clarification by me (the President)."

Accordingly, the NSC meeting scheduled for Friday has been cancelled.

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SUBJECT: Talking Points on the US-USSR Joint Commercial Commission Meeting Scheduled for May 20-21 in Moscow

3. The question at Saturday's meeting will be the circumstances under which the JCC meeting should be allowed to proceed, if at all. This makes moot for the time being the substantive question of expanding US exports of oil and gas equipment and focuses attention on the political environment and the kind of signal the Administration wishes to convey.

David B. Low

Attachments:

A. The May 1985 JCC and the Soviet Agenda
B. Western Technology and Equipment and Soviet Energy
C. Background on Energy Projects Requested by Moscow for JCC Discussion
D. Future Declines in Soviet Oil and Gas Earnings

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NIO/Econ/DL:rr [redacted] 25 April 1985 NIC 02177-85 25X1

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ATTACHMENT A

25 April 1985

THE MAY 1985 JCC AND THE SOVIET AGENDA

The ramifications of the May 20-21 meeting of the US-USSR Joint Commercial Commission--the first in six years--will be more political than economic.

-- Although generally disappointed with the contributions to their economy of Western technology and equipment, the Soviets continue to hope for economic benefit in obtaining US technology and goods.

-- More importantly at this stage, they view increased trade with the US as a necessary adjunct to a general normalization of relations and as an opportunity to gauge US commitment to normalization.

Accordingly, Moscow probably expects the US to show some flexibility in these talks. At the same time, the Soviets probably do not expect substantial progress on key issues.

-- The Soviets hope that the prospect of increased trade will cause affected US businessmen to urge the US Administration to avoid policy decisions that Moscow would view as hostile (such as stronger COCOM controls) and to adopt conciliatory positions on broader issues such as arms control.

-- Some Soviet statements to US businessmen strongly suggest that the two issues of arms control talks and renewal of US-Soviet trade talks are closely linked in the minds of the Soviet leadership.

While Moscow already has concluded, and will continue to conclude, a few contracts to US suppliers, economic realities constrain any rapid growth in bilateral trade over the 1985-1990 period.

-- Moscow has developed alternative suppliers in Eastern and Western Europe to reduce dependence on US goods.

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SUBJECT: The May 1985 JCC and the Soviet Agenda

-- The Soviets will have a smaller capacity for hard currency earnings, at least through 1990, as a result of stagnant or falling oil production.

-- Moscow will be selective in its equipment imports because of past problems in productively assimilating Western technology.

Despite technical advantages in some product areas, US firms would not likely see a large rise in sales absent government restrictions until overall relations with the USSR improve.

-- In FY 1983 and 1984 export licenses in preparation for bidding on Soviet projects were granted for $356 million in US sales.

-- Commerce Department can only confirm $2.6 million in shipments over the period although the total may be in the range of $6 to $10 million. This presumably reflects the Soviet "black-listing" of US firms.

-- Political considerations aside, favorable financial terms and the high dollar give West European and Japanese suppliers a competitive edge in areas where their equipment is nearly on a par with US quality.

At the January 1985 preliminary meeting between Under Secretary Olmer and Deputy Foreign Trade Minister Sushkov, the latter stated that, while the USSR was not expecting major improvements, he felt it would be useful to see progress on such issues as port access for Soviet ships, bans on US imports of Soviet furs and nickel, and the refusal to recertify Aeroflot flights into this country.

-- The Soviets may be encouraged by such recent acts as the US government's failure to ban imports of selected Soviet goods on the ground that forced labor was used in their manufacture, and the easing of certain COCOM restrictions (on personal computers, for example).

-- More serious trade issues such as the granting of MFN status, the reduction of trade controls on sensitive items or government guarantees of contract sanctity they understand will probably not be resolved soon.

See attached a list of the projects for discussion at the JCC Meeting provided by the Soviet Trade Representative's office. Only the first five aopear to raise significant security issues.

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25X1

ATTACHMENT B

25 April 1985

WESTERN TECHNOLOGY AND EQUIPMENT AND SOVIET ENERGY

Background

The USSR is the world's leading producer of oil and natural gas. By 1970, oil had displaced coal as the dominant fuel in the Soviet energy balance, and we anticipate by 1990 natural gas will account for the largest share of the USSR's primary energy production.

Oil output slipped to 12.3 million barrels per day last year, down about 100,000 from 1983--the first year-to-year decline since WWII.

-- The falloff is due primarily to the advanced age of most of the largest oil fields.

-- We expect an even larger decline in 1985, while investment in the industry is planned to increase by about 15 percent.

-- Over the last several years oil production efforts have been pushed in the near-term to the detriment of needed oil exploration. Now, at the oldest oil fields in West Sibera, production per well is down amidst wide-spread equipment and corrosion problems. The newer fields are smaller and less productive with increased need for pumps and maintenance.

-- Meanwhile, there have been two waves of management changes in the oil ministry.

On the other hand, natural gas production has been growing at 7 percent annually, and the outlook for continued growth is excellent. Coal production continues to stagnate.

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SUBJECT: Western Energy Technology and Equipment and Soviet Energy

The Need for Western Energy Technology and Equipment

Efforts to halt the decline in oil production and to develop certain new gas reserves will force the Soviets to look to Western technology and equipment.

-- Oil exploration and development is shifting to deeper deposits, for which efficient exploitation requires Western exports including seismic and drilling equipment as well as Western technology for designing, producing, and integrating this equipment.

-- The need for Western equipment will be particularly high to exploit sour oil and gas from high-temperature and high-pressure deposits in the Pre-Caspian Depression.

-- While the Soviets could continue to rely on indigenous capability and shift the natural gas efforts to deposits more easily developed, access to Western technology and equipment would reduce project development times, cutting some by nearly half.

Most equipment the Soviets will need is available from non-US suppliers, although US firms and their affiliates and licensees abroad are still generally the producers of the highest quality goods in most areas.

-- US dominance of the worldwide petroleum equipment industry has substantially eroded over the last ten years.

-- Equipment production capabilities in Western Europe and Japan have been increasing rapidly over the last few years as they have invested heavily to participate in development of North Sea oil and gas.

-- The United States still maintains a substantial qualitative edge in certain electronic sensing and data processing gear necessary for seismic exploration and deep offshore drilling as well as advanced metallurgical capabilities for high-temperature and high-pressure corrosion-resistant equipment, for drilling and production.

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Subject: Western Technology and Equipment and Soviet Energy

Military Use

Substantial potential for diversion of Western electronics and metallurgical technology embodied in petroleum equipment to military-related use is believed to exist in the sale of "high-level" equipment.

-- Much of the more sophisticated electronics technologies have broad military-naval applications [redacted] 25X1

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-- [redacted]

-- [redacted] 25X1

Denial

During the past few years, the United States has developed a comprehensive policy aimed at stemming the flow of high-quality Western technology and equipment to the USSR and other Warsaw Pact countries by expanding and upgrading export controls.

-- A formal US proposal addressing emerging technologies and 21 oil and gas technology and equipment items was tabled in COCOM, and several items were accepted for full COCOM control in January 1984.

-- Partial control was obtained over several other items, and discussions on the remaining items were temporarily deferred or dropped.

-- US national security controls cover essentially the same items as COCOM while unilateral foreign policy controls cover the remaining exploration and production items.

SUBJECT: Western Energy Technology and Equipment and Soviet Energy

-- While these efforts probably have reduced Soviet access to clearly "dual use" technologies embedded in Western petroleum equipment, they have not significantly impeded Soviet efforts to acquire Western gear needed to upgrade petroleum operations so far.

Denial of Western production equipment for operation in corrosive and high-pressure, high-temperature environments would substantially slow progress in development of the petroleum resources in the Pre-Caspian Depression and Central Asia.

-- It would also have serious--but not crippling--consequences for operations in West Sibera.

-- Where operations were not halted by a lack of Western technology and equipment, the myriad of inefficiencies associated with the use of domestically-manufactured obsolescent equipment of poor quality would boost production costs and tend to reduce the percentage of oil in place that ultimately will be recovered.

-- In any event, the lead time for such projects is so long that the impact on production would not be significant until the 1990s.

Even under the conditions indicated, the Soviet Union would be able to supply its own essential needs for oil, including those of the armed forces.

-- Unilateral action by the United States would have very little impact.

-- Concerted action by all COCOM members would slow many Soviet projects, raise their energy investment costs, and, in turn, impose costs on other sectors of the economy. In light of recent US experience in COCOM, however, it is doubtful that COCOM would agree to any significant further expansion of petroleum equipment-related export controls.

It is possible that these added costs and delays could, if coupled with other considerations, promote tactical adjustments in Soviet foreign policy. But we do not believe these pressures would be sufficient to force basic changes in Soviet defense and foreign policies.

FOREIGN AVAILABILITY OF EXPLORATION, DRILLING AND PRODUCTION TECHNOLOGY FROM NON-US WESTERN SUPPLIERS IN 1985

Exploration Technology

High quality services and good foreign equipment available elsewhere, [redacted] although US is preferred supplier for acoustical/ultrasonic sensors and geophysical equipment. 25X1

Drilling Technology

High quality services and gear available outside US.

Production Equipment

US equipment is preferred for most "downhole" needs, including packers, seals, valves, and submersible pumps. Other equipment is available overseas.

Pipeline Construction

Equipment is available overseas.

Processing and Refining Technology

Equipment for most applications is available overseas.

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ATTACHMENT C

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BACKGROUND ON ENERGY PROJECTS REQUESTED BY MOSCOW FOR JCC DISCUSSION

Astrakan' Gas Development

Construction of this deep onshore gas field began in 1983 with stages II and III worth about $1.2 billion now out for bids. The Soviets expect the field to produce 18 billion cubic meters of gas sometime in the 1990s. Engineering and management services and equipment for future construction are generally available from non-US sources. Moscow may look to the US for "downhole" equipment such as packers and safety valves.

Gas Compressors for Karachaganak

This is a $500 million gas field project including wells, pipelines, and a gas processing plant; the project is already underway. A second plant planned for construction will need at least three compressor stations. Foreign firms and offshore affiliates and licensees of US firms are capable of supplying the services and equipment for future development.

Underwater Wellhead Equipment

Moscow will likely step up development of offshore Caspian Sea oil and gas over the next five years. US firms and subsidiaries are preferred suppliers of subsea wellhead equipment, but Norwegian, French, and British companies are prepared to enter the market.

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SUBJECT: Background on Energy Projects Requested by Moscow for JCC Discussion

Ice Tolerant Platforms for Sakhalin

Sakhalin development is stalled absent a Japanese commitment to purchase 3 million tons of LNG annually. Should the project get underway, three or more platforms could be added in waters 30 to 90 meters deep at an average cost of $100 million per unit. Numerous foreign countries including Japan and Korea could supply platforms for this project.

Ice-Resistant Offshore Platform Construction Yards

Platforms from the planned yards would be used in waters of the Barents', Kara, and Okhotsk Seas. Several West European countries plus Canada and Japan would be able to supply equipment and construction services for these yards at cost ranging from $10 to $40 million per yard.

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ATTACHMENT D

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FUTURE DECLINES IN SOVIET OIL AND GAS EARNINGS

Hard currency earnings from exports of oil and gas will likely fall sharply over the next five years.

-- Oil production declined slightly in 1984; hard currency oil exports were maintained primarily by increasing reexports of OPEC oil obtained by barter.

-- Oil sales account for nearly half of the Soviet Union's roughly $32 billion annual hard currency earnings.

Even if the Soviets are able to sustain oil production at just under current levels and keep domestic use from rising, hard currency earnings from oil measured in constant dollars could decline by more than 50 percent by 1990.

-- Should oil production decline by 1 million b/d as some experts predict, earnings would fall even more sharply to perhaps only one quarter of current levels.

-- In either case, the decline in earnings will be even greater if the presumed decline in deliveries to Eastern Europe is not continued.

Gas sales cannot make up for lost oil earnings over the 1985-90 time period.

-- Even under a maximum export scenario, hard currency earnings from gas sales will rise by only about $1 billion in real terms over the next five years.

The hard currency earnings decline (measured in constant dollars) from reduced oil exports will become worse by the year 2000 even if oil production can be maintained and real oil prices rise.

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SUBJECT: Future Declines in Soviet Oil and Gas Earnings

-- If the West Europeans abide by their agreement to limit gas dependence, total earnings from oil and gas in the year 2000 will range from 40 percent to less than 70 percent of current earnings. Extensive use of Western energy technology and equipment would be needed to keep oil production and, hence, revenues at the high end of the range.

-- Gas exports can make up the earnings gap in this time frame only if the Soviets can convince the Europeans to buy 120 billion cubic meters per year--roughly triple current levels.

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OIL PRODUCTION, EXPORTS, AND REVENUES

(million b/d)

	1983 Actual	1990	2000
Production	12.3	11.0 - 12.0	10.0 - 12.0
Internal Consumption	9.0	9.3	8.6 - 9.4
Soft Currency Exports	2.2	1.4 - 2.0	1.4 - 2.0
Hard Currency Exports	1.4	0.5 - 0.9	0.2 - 0.8
(Earnings, billion 1983$)	(15.6)	(3.90 - 7.0)	(1.7 - 6.9)

GAS PRODUCTION, EXPORTS, AND REVENUES

(billion cubic meters)

	1983 Actual	1990	2000
Production	536	620	950 - 1,000
Consumption	478	548	815 - 826
Soft Currency Exports	35	38	67
Hard Currency Exports	26	37	60 - 120
(Earnings, billion 1983$)	(3.2)	(4.1)	(5.8 -10.5)

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